Supreme Court, U.S.
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No. 04-

IN THE

Supreme Court of the United States

HANS W. FLAGG AND EILEEN S. FLAGG, on behalf of themselves and all others similarly situated,

Petitioners,

v.

YONKERS SAVINGS AND LOAN ASSOCIATION, FA, also known as Yonkers Financial,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the preemption by the Office of Thrift Supervision ("OTS") of state statutes requiring the payment of interest on balances in mortgage escrow accounts maintained for mortgage loans originated or serviced by federal savings and loan associations ("FS&L's") is inconsistent with Congress' intent as expressed under § 2616 of the Real Estate Settlement Procedures Act ("RESPA," 12 U.S.C. § 2601, *et seq.*), and as further interpreted by the Secretary of Housing and Urban Development (the "Secretary"), the agency official designated in 12 U.S.C. § 2616 to make preemption determinations with respect to mortgage escrow accounts for all federally-related mortgage loans?

2. Whether the OTS preemption regulations that "freed [Respondent and other FS&L's] from any legal duty to pay interest on mortgage escrow accounts" arising under state law constitutes a state action "nexus" sufficient to support a claim against Respondent under the Takings Clause of the Fifth Amendment to the United States Constitution?

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OPINIONS BELOW

The Opinion of the United States District Court for the Southern District of New York dismissing Petitioners' claims is reported at *Flagg v. Yonkers Sav. & Loan Ass'n, FA*, 307 F. Supp. 2d 565 (S.D.N.Y. 2004) (App. B, *infra*, 16a). The Opinion of the United States Court of Appeals for the Second Circuit affirming the dismissal by the district court is reported at 396 F.3d 178 (2d Cir. 2005) (App. A, *infra*, 1a). The Order of the Second Circuit denying Petitioners' petition for rehearing is unreported (App. C, *infra*, 59a).

STATEMENT OF JURISDICTION

The Second Circuit's Opinion was entered on January 21, 2005. The Second Circuit's Order denying Petitioners' timely petition for rehearing was entered on February 15, 2005. Petitioners invoke this Court's jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

The statutory basis for the mortgage escrow interest to which Petitioners claim entitlement is, *inter alia*, New York General Obligations Law ("GOL") Section 5-601, governing "Interest on deposits in escrow with mortgage investing institutions," and which generally requires the payment of 2% escrow interest on all escrow balances for New York residential mortgages (App. D, *infra*, 61a).

Congress' intent with respect to the preemption of state escrow laws is found in RESPA, and in particular the RESPA savings provision, 12 U.S.C. § 2616, "State laws unaffected; inconsistent Federal and State provisions" (App. D, *infra*, 61a-62a).

The principal statutory authority of the OTS to regulate FS&L's is found in the Home Owners' Loan Act of 1933 ("HOLA"), 12 U.S.C. § 1463(a) and § 1464(a) (App. D, *infra*, 62a-63a).

The OTS regulations preempting state escrow interest laws are 12 C.F.R. § 545.2 and 12 C.F.R. § 560.2 (App. D, *infra*, 63a-65a).

Petitioners' alternative taking claim is based on the Fifth Amendment to the United States Constitution, which provides that "private property [shall not] be taken for public use, without just compensation."

STATEMENT OF THE CASE

I. Factual Background

Petitioners Hans and Eileen Flagg entered into a mortgage agreement with Respondent FS&L Yonkers Savings and Loan Association, FA, on June 12, 1998 for their residence located in Westchester County, New York. At the time of closing, Petitioners had to deposit more than $4000 into an escrow account required to be maintained under the terms of the mortgage agreement for the payment of property taxes, insurance and other prescribed items. Monthly escrow account deposits required by Respondent ranged from $835-$1000, and the escrow account balance in some months exceeded $6000, during the life of the loan.

The standard form mortgage agreement included a term entitled "Lender's Obligations" regarding the payment of escrow interest, providing in relevant part:

> Lender will not be required to pay me any interest or earnings on the Funds [held in escrow] unless either (i) Lender and I agree in writing, at the time I sign this Security Instrument, that Lender will pay interest on the Funds; or (ii) the law requires Lender to pay interest on the Funds.

With respect to the governing law, the mortgage agreement stated: "This Security Instrument is governed by federal law and the law that applies in the place where the Property is located."

Respondent never paid Petitioners interest on their escrow account at any time before Respondent merged with the Atlantic Bank of New York ("Atlantic Bank") in May, 2002. After the

merger, Atlantic Bank, a New York State chartered banking institution, began to pay Petitioners interest on their escrow account under the same mortgage agreement. Petitioners estimate that the total escrow interest not paid by Respondent under New York law between 1998 and 2002 equals or exceeds $400.

Petitioners subsequently commenced a class action on behalf of themselves and other similarly situated borrowers who were not paid escrow interest by Respondent required under New York law. Petitioners' complaint, *inter alia*, sought a declaration that the New York statutes requiring the payment of escrow interest are preserved under RESPA, 12 U.S.C. § 2616, and also asserted a claim for breach of contract under the terms of the mortgage agreement. Alternatively, Petitioners asserted a taking claim under the Fifth Amendment to the U.S. Constitution, insofar as their entitlement to the prescribed escrow interest was determined to be preempted by the OTS and federal law. The jurisdiction of the district court was based on 28 U.S.C. § 1331, in that the complaint includes a claim asserted and arising under the Takings Clause of the Fifth Amendment, and under 28 U.S.C. § 1367 with respect to Petitioners' other claims involving substantial related federal questions.

II. Statutory And Regulatory Background, Including Relevant Statutory And Regulatory History

A. The New York State Escrow Interest Statutes

New York GOL § 5-601 obligates the payment of 2% interest on New York mortgage escrow accounts by all "mortgage investing institutions" (App. D, *infra*, 61a). "Mortgage investing institutions," in turn, are defined under New York Banking Law ("BL") § 14(5) to include "any bank, trust company, national bank, savings bank, savings and loan association [or] federal savings and loan association." New York Real Property Tax Law § 953(2) and BL § 6-k(2)(b) contain provisions comparable to GOL § 5-601 requiring the payment of interest by mortgage investing institutions in connection with escrow accounts established for the payment of real property

taxes and insurance premiums, respectively. There is no dispute that Respondent is a mortgage investing institution included within the ambit of the New York escrow interest statutes.

Some thirty years ago, the New York escrow interest statutes at issue in this case were upheld by a three judge panel in the face of challenges lodged by a state savings association and by the Federal National Mortgage Association ("FNMA"). *See Jamaica Sav. Bank v. Lefkowitz*, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975); *FNMA v. Lefkowitz*, 390 F. Supp. 1364 (S.D.N.Y. 1975). The three judge panel in *Jamaica Sav. Bank* specifically found that the statutes were enacted "for the benefit of a class [of homeowners] that needed protection," 390 F. Supp. at 1362-63, and described the New York legislature's purpose as follows:

> What occurred in this case was that the state legislature created a remedy to a problem it perceived – the inability of citizens seeking mortgages from mortgage lending institutions to bargain effectively for the use of funds put into the hands of the institutions to secure the mortgaged premises. . . . These mortgage agreements – almost all identical – were drafted by the [lender] and essentially were offered to potential mortgagors on a take it or leave it basis. 390 F. Supp. at 1362.

In rejecting the FNMA challenges to the statutes in *FNMA v. Lefkowitz*, 390 F. Supp. at 1369-70, the three judge panel also observed that the requirement to pay escrow interest "in no way" interfered with FNMA's functions or the ability of mortgagees (like Respondent) to protect their interest in property, because the purpose of requiring advance escrow deposits "is not to provide FNMA [or the lenders] with income."[1]

---

[1] In addition to New York, other states and federal territories with statutes requiring the payment of interest on mortgage escrow account (Cont'd)

B. RESPA, Its Savings Provision, And The Secretary's Regulations

RESPA was enacted in 1974, with the express purpose enumerated in 12 U.S.C. § 2601(b)(3) of "effect[ing] certain changes in the settlement process for residential real estate that will result . . . in a reduction in the amounts home buyers are required to place in escrow accounts established to insure the payment of real estate taxes and insurance[.]" The broad reach of RESPA is evidenced by its definition in 12 U.S.C. § 2602(1) of a covered "federally related mortgage loan," which extends to mortgage loans by virtually every federal and state bank, association and mortgage lender if, *inter alia*, the lender's deposits or accounts are federally insured or it is federally regulated.

As enacted in 1974, and as amended by Congress in 1990 under Public Law 101-625, 104 Stat. 4411 (Nov. 28, 1990), RESPA imposes escrow account restrictions and obligations on a lender beginning at closing and extending throughout the life of the escrow account.[2] Congress has designated the Secretary as the federal administrator with responsibility for issuing regulations and making other escrow account related determinations in furtherance of the purposes of RESPA.

(Cont'd)
balances include, *inter alia*, Connecticut and Vermont within the Second Circuit, Kentucky, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, Rhode Island, Wisconsin, Guam and the Virgin Islands.

[2] *See* 12 U.S.C. § 2605(g) (requiring loan servicer "to make payments from the escrow account . . . in a timely manner as such payments become due"); 12 U.S.C. § 2609(a)(2) (prescribing maximum amount lender may require borrower to place in escrow account); 12 U.S.C. § 2609(b) ("servicer shall notify the borrower not less than annually of any shortage of funds in the escrow account"); 12 U.S.C. § 2609(c)(2) (requiring annual escrow statements not less than once annually); 12 U.S.C. § 2609(d) (imposing penalties not exceeding $100,000 "for all such failures during any 12-month period").

See 12 U.S.C. § 2602(6); 12 U.S.C. § 2605(j)(3); 12 U.S.C. § 2609(c)(1)(C); 12 U.S.C. § 2616.

Congress' intent under RESPA with respect to federal preemption and the Secretary's preemption-authority is stated in 12 U.S.C. § 2616:

> This chapter does not annul, alter, or affect, or exempt any person subject to the provisions of this chapter from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this chapter, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether such inconsistencies exist. The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.

The Secretary's RESPA regulations are found at 24 C.F.R. § 3500. The regulation regarding escrow accounts is 24 C.F.R. § 3500.17. The escrow account regulation contains several instances where the Secretary specifically requires lenders and servicers to comply with state escrow laws that provide greater protection than § 3500.17. *See* 24 C.F.R. § 3500.17(c)(8) (Secretary's regulation applies unless state law provides for lower escrow account limit); 24 C.F.R. § 3500.17(d)(1)(i)(C) (escrow cushion is two months' payments or lesser amount specified by state law); 24 C.F.R. § 3500.17(d)(1)(ii) (lowest monthly balance is 1/6 total estimated disbursements or lesser amount specified by state law).

In 1994, the Secretary promulgated a number of amendments to the RESPA regulations. Included was a preemption regulation, 24 C.F.R. § 3500.13, "Relation to State laws," in furtherance of the RESPA savings provision, 12 U.S.C. § 2616. As the Secretary observed with respect to the preemption regulation, 59 Fed. Reg. 53890, 53900 (Oct. 26, 1994):

> *Regarding the possible preemption of State laws, the Department recognizes that many of the States have*

> *enacted laws relating to escrow accounts.* Section 18 of RESPA provides: "This Act does not annul, alter, or affect, or exempt any person subject to the provisions of (RESPA) from complying with, the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of (RESPA), and then only to the extent of the inconsistency." 12 USC 2616. *Given this statutory language, and further statutory instruction that a state statute is not to be preempted if it gives greater protection to the consumer*, the Department believes it should make specific preemption decisions on a case-by-case basis. (emphasis added)

In the same Federal Register document, 59 Fed. Reg. at 53891, the Secretary also specifically discussed the obligation of the lender of a "federally related mortgage loan" to pay escrow interest if required under state laws:

> Interest on Escrow Accounts[.]
>
> Commenters asked whether the final rule would address interest on escrow accounts. Seven commenters suggested that the rule specifically exempt servicers that either pay interest on escrow accounts or service only one escrow item. These commenters believed that a required interest payment on escrow account balances would create a disincentive to servicers to over-escrow.
>
> After considering the comments, the Department determines that it will not create the requested exemptions. The Department does not interpret Section 10 of RESPA as providing the Department with legal authority to require payment of interest on escrow accounts. *Where interest is required, it is a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds.* (emphasis added)

RESPA's legislative history also demonstrates Congress' awareness of state statutes requiring the payment of escrow

interest when Congress considered and passed RESPA. First are the dissenting views of Rep. Leonor K. Sullivan in 1975 regarding RESPA's 1974 enactment, as found in H.R. Rep. No. 94-667 (1975), *reprinted in* 1975 U.S.C.C.A.N. 2448, 2461:

> In 1972, the Committee voted to include in the comprehensive Housing bill reported that year a provision calling upon the Federal Reserve Board to investigate the feasibility of requiring interest to be paid by mortgage lenders on the escrow accounts they require mortgagors to establish and maintain for the payment of taxes and casualty insurance. When the 1972 Housing bill died in the Rules Committee that year, I asked the General Accounting Office to make such a study, and it did so.
>
> The GAO reported that about $9 ½ billion was being placed over a year's time in such accounts on one to four family dwelling units, that an infinitessimal number of such accounts were interest bearing (except in the few states which require interest to be paid on such accounts) and that many lenders— particularly large institutions with many mortgages outstanding— derived substantial profits from the temporary investment of those funds.
>
> * * *
>
> Based on the GAO finding, *I proposed including in RESPA last year a provision which would not require interest to be paid on escrow accounts but instead would give individual home buyers the option of paying their own taxes and insurance rather than being required by the lender to maintain an interest-free escrow account for this purpose.* This proposal was rejected by the Committee last year and again on the bill now before us. . . . That is unfortunate, because many of our home-buying constituents with sizeable real estate tax bills each year would prefer to pay the taxes directly, meanwhile investing the money in

> interest-bearing accounts. Under most home mortgages, however, the home buyer does not have that option. . . . (emphasis added)

RESPA's 1974 legislative history also suggests that the House specifically considered the payment of escrow interest as related to the scope and purposes of RESPA:

> The House amendment contains a provision providing for the Federal Reserve Board to conduct a study by June 30, 1975, on the feasibility of lenders paying interest on escrow accounts and related questions. The Senate bill has no similar provision, and none is contained in the conference report. (emphasis added)

H.R. Conf. Rep. No. 93-1526 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6569, 6572. Importantly, the RESPA legislative history states the following regarding the preemption of state consumer protection laws *on the very same page* discussing "the feasibility of lenders paying interest on escrow accounts:"

> *The House amendment permits States to enforce consumer protection requirements in connection with residential real estate transactions in addition to requirements of this Act.* The Senate bill has no similar provision. The conference report contains the House provision with an amendment which would conform this provision to the recently enacted amendments to the Truth-in-Lending Act (Public Law 93-495) defining the relationship of that law to State laws [as enacted in 12 U.S.C. § 2616]. (emphasis added)

C. HOLA And The OTS Escrow Interest Preemption Regulations

Respondent and other FS&L's are chartered pursuant to HOLA, which was first enacted in 1933. The term "escrow account" does not appear even once in HOLA.

Congressional intent and authority for the Director of the Federal Home Loan Bank Board ("FHLBB") (now the OTS) to regulate FS&L's is found in 12 U.S.C. §§ 1463(a) and 1464 (a). Pursuant to 12 U.S.C. § 1463(a)(3) (App. D, *infra*, 62a),

Congress directed the OTS to "exercise all powers granted to the Director under this chapter so as to encourage savings associations to provide credit for housing safely and soundly." Pursuant to 12 U.S.C. § 1464(a) (App. D, *infra*, 63a), Congress directed the OTS to regulate the operations of federal savings associations "giving primary consideration of the best practices of thrift institutions in the United States . . . to encourage such institutions to provide credit for housing safely and soundly."

With the exception of 12 U.S.C. § 1463(g) regarding state usury laws, HOLA contains no provision specifically evidencing Congressional intent regarding the federal preemption of state laws. HOLA does, however, include a number of provisions specifically preserving and subjecting federal savings associations to state law, including: (i) 12 U.S.C. § 1464(b)(3) (borrowing from state housing finance agencies to same extent as state associations); (ii) 12 U.S.C. § 1464(h) (federal associations are subject to state and local taxes if not discriminatory); (iii) 12 U.S.C. § 1464(n)(1) (same "right to act as trustee . . . or in any other fiduciary capacity" as under state law); and (iv) 12 U.S.C. § 1464(n)(3) (oaths and affidavits under state law).

In the 1970's, FHLBB regulation 12 C.F.R. § 545.6-11(c) *required* the payment of interest on escrow funds by FS&L's if such payments were required of state lending institutions under state law where the FS&L's were located. *See First Fed. Sav. & Loan Ass'n of Boston v. Greenwald*, 591 F.2d 417, 420 n.3 (1st Cir. 1979).

In 1982, the Supreme Court issued its decision in *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982) ("*de la Cuesta*"). Specifically, the Court held that the FHLBB regulation permitting FS&L's to exercise the due-on-sale clause of a standard mortgage agreement – a clause the FHLBB considered critical to the business of banking by FS&L's – barred the application of a contrary state doctrine prohibiting

unreasonable restraints on alienation of property. 458 U.S. at 155, 168. In reaching its holding, the Supreme Court observed:

> The broad language of § [1464](a) expresses no limits on the Board's authority to regulate the lending practices of federal savings and loans. As one court put it, "[i]t would have been difficult for Congress to give the Bank Board a broader mandate." 458 U.S. at 161 (quoting *Glendale Federal Sav. & Loan Assn. v. Fox*, 459 F. Supp. 903, 910 (C.D. Cal.1978)).

Within one year after *de la Cuesta*, in 1983, the FHLBB eliminated all substantive regulations regarding escrow accounts, including 12 C.F.R. § 545.6-11(c), the substantive regulation requiring the payment of interest if so required under state law. As stated by the FHLBB at that time:

> In the final amendments the Board has decided to remove the substantive provisions pertaining to escrow accounts, allowing such matters to be governed by the loan contract and in their place require a more detailed disclosure about the accounts. Of course, associations will remain subject to the requirements of RESPA in addition to the Board's regulations and, if consistent with that statute, may require escrow accounts to the extent agreed to in the loan contact.
>
> * * *
>
> In light of this disclosure and the provisions of RESPA, the Board believes that the existing provisions on escrow accounts are no longer necessary and for that reason has deleted them.

48 Fed. Reg. 23032, 23039 (May 23, 1983).

In the place of specific substantive regulations, the FHLBB had, and the OTS now has, two regulations purporting generally to preempt all state laws affecting the operations of FS&L's, and directly at issue here. Most germane here is 12 C.F.R. § 560.2 (App. D, *infra*, 64a-65a), which governs federal

preemption in the lending and investment practices of FS&L's, and provides in relevant part:

> (a) Occupation of field. Pursuant to sections 4(a) and 5(a) of the HOLA, 12 U.S.C. 1463(a), 1464(a), OTS is authorized to promulgate regulations that preempt state laws affecting the operations of federal savings associations when deemed appropriate to facilitate the safe and sound operation of federal savings associations, to enable federal savings associations to conduct their operations in accordance with the best practices of thrift institutions in the United States, or to further other purposes of the HOLA. To enhance safety and soundness and to enable federal savings associations to conduct their operations in accordance with best practices (by efficiently delivering low-cost credit to the public free from undue regulatory duplication and burden), *OTS hereby occupies the entire field of lending regulation for federal savings associations. OTS intends to give federal savings associations maximum flexibility to exercise their lending powers in accordance with a uniform federal scheme of regulation.* Accordingly, federal savings associations may extend credit as authorized under federal law, including this part, without regard to state laws purporting to regulate or otherwise affect their credit activities. . . . (emphasis added)
>
> (b) Illustrative examples. . . . [T]he types of state laws preempted by paragraph (a) of this section include, without limitation, state laws purporting to impose requirements regarding. . . .
>
> * * *
>
> (6) Escrow accounts, impound accounts, and similar accounts[.]

Additionally relevant is 12 C.F.R. § 545.2 (App. D, *infra*, 63a), the regulation governing the preemption of state laws in the general operations of FS&L's:

> The regulations in this part 545 are promulgated pursuant to the plenary and *exclusive authority of the Office to regulate all aspects of the operations of Federal savings associations*, as set forth in section 5(a) of the Act. This exercise of the Office's authority is preemptive of any state law purporting to address the subject of the operations of a Federal savings association. (emphasis added)

Since the promulgation of the preemption regulations in 1983, the FHLBB and OTS have issued a number of Opinion Letters reiterating their position that FS&L's are exempt from state escrow interest laws on federal preemption grounds. Respondent submitted a number of these letters to the district court in support of its motion to dismiss, and the district court credited the letters in its decision granting Respondent's motion (App. B, *infra*, 32a-34a).

In fact, Respondent also obtained and submitted an October 6, 2003 Opinion Letter from the OTS *in this litigation* to further establish that it was exempt from paying escrow interest under the OTS preemption regulations. The district court, however, declined to accord deference to the October 6, 2003 Opinion Letter, "because it does not address the impact of RESPA on [Petitioners'] contentions and thus fails to consider [Petitioners'] principal argument against the federal preemption of the New York statutes (App. B, *infra*, 32a-33a at n.12).

REASONS FOR GRANTING THE PETITION

The issue whether the preemption by the OTS of state escrow interest statutes is inconsistent with Congress' intent, as expressed under § 2616 of RESPA and as further interpreted by the Secretary, presents an important federal preemption issue. Its resolution by this Court affects hundreds of thousands of American citizens (or more) residing in the many states and territories that have seen fit to provide borrowers with the

additional protection of escrow interest preserved by Congress but improperly circumvented by the OTS. Aside from this Court's holdings establishing the primacy of Congressional intent and the presumption against preemption, the issue also implicates the Court's prior decisions regarding the appropriateness of the rules of specificity and recency as aids in resolving the interplay between different federal acts and statutes. Additionally, the issue implicates this Court's administrative law jurisprudence regarding the appropriate level of *Chevron* deference when the roles of two different federal agencies empowered under two different federal acts arguably intersect. It is fair to say that the Second Circuit either substantially departed from or simply failed to consider all of these controlling and other pertinent Supreme Court decisions.

The taking issue in this case is equally compelling. The issue is a natural extension of this Court's recent decisions in *Phillips v. Washington Legal Found.*, 524 U.S. 156 (1998), and *Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003), addressing the Fifth Amendment taking implications of the interest earned on funds deposited into IOLTA accounts. The Second Circuit's conclusion that the facts of this case lack the necessary state action to implicate the Takings Clause ignores the decisions of this and other courts, as well as the Opinions of the OTS, confirming that FS&L's are federal instrumentalities whose conduct can trigger constitutional protections. The Second Circuit similarly overlooked or misapplied the decisions of this Court that not just federal coercion, but "significant encouragement," can satisfy the nexus for state action sufficient to trigger Fifth Amendment protections. Simply stated, if the only reason a FS&L does not pay the escrow interest required by state law is because the OTS "frees" it from doing so (as the Second Circuit found here), then the failure to do so is (or should be, Petitioners contend) properly attributable to the federal government regardless of whether the FS&L is a federal instrumentality, or instead is merely the "private corporation" that the Second Circuit considered Respondent to be.

Unlike IOLTA interest, however, the escrow interest at issue here is readily calculable and payable to its owners. Escrow interest was and is paid by thousands of non-FS&L banking institutions nationally every year, and the proper amount can be derived from the escrow account information already required to be provided to all borrowers annually under 12 U.S.C. §§ 2609(b) and 2609(c)(2). It is fair to say that the borrowers affected by the OTS regulations could number in the hundreds of thousands or more, and the escrow interest taken could total in the hundreds of millions or more dollars – every year. This Court alone is in a position to definitively put an end to the improper FS&L escrow interest practices described herein, and to render a determination enabling affected borrowers to retain and recoup what is rightly theirs, while restoring the proper balance – prescribed by Congress and consistent with its intent – for the relationship between federal and state laws regarding escrow accounts, and the Constitutionally mandated respect for the property of mortgage borrowers.

I. Review Is Warranted Because The Second Circuit Opinion Substantially Departs From Or Fails To Consider This Court's Controlling And Other Pertinent Decisions

Petitioners argued to the Second Circuit, without success or even acknowledgment, that the appropriate framework for the preemption analysis in this case is the one set out by the Supreme Court, *inter alia*, in *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485-86 (1996):

> First, because the States are independent sovereigns in our federal system, we have long presumed that Congress does not cavalierly pre-empt state-law causes of action. In all pre-emption cases, and particularly in those in which Congress has "legislated . . . in a field which the States have traditionally occupied," *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 1152, 91 L. Ed. 1447 (1947), we "start with the assumption that the historic police powers of the States

were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." [*Id.*]

* * *

Second, our analysis of the scope of the statute's pre-emption is guided by our oft-repeated comment, initially made in *Retail Clerks v. Schermerhorn*, 375 U.S. 96, 103, 84 S. Ct. 219, 222, 11 L. Ed.2d 179 (1963), that "*[t]he purpose of Congress is the ultimate touchstone" in every pre-emption case. . . . As a result, any understanding of the scope of a pre-emption statute must rest primarily on "a fair understanding of congressional purpose.*" . . . Congress' intent, of course, primarily is discerned from the language of the pre-emption statute and the "statutory framework" surrounding it. . . . Also relevant, however, is the "structure and purpose of the statute as a whole," . . . as revealed not only in the text, but through the reviewing court's reasoned understanding of the way in which Congress intended the statute and its surrounding regulatory scheme to affect business, consumers, and the law. (emphasis added) (citations omitted)

The primacy of Congress' intent, as expressed in 12 U.S.C. § 2616, was turned on it head by the Second Circuit in the first two paragraphs of its legal analysis (App. A, *infra*, 5a-6a):

"Federal regulations have no less pre-emptive effect than federal statutes. Where Congress has directed an administrator to exercise his discretion, his judgments are subject to judicial review only to determine whether he has exceeded his statutory authority or acted arbitrarily. When the administrator promulgates regulations intended to pre-empt state law, the court's inquiry is similarly limited." [quoting *de la Cuesta*, 458 U.S. at 153-54] . . .

> This evaluation is usually informed by a presumption in favor of the authority of state law in areas of activity traditionally allocated to the supervisory organs of the various states. *See Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947). The presumption against federal preemption disappears, however, in fields of regulation that have been substantially occupied by federal authority for an extended period of time. . . . Regulation of federally chartered banks is one such area. [citations omitted]

It was no surprise where the Second Circuit's decision would lead, in light of its articulated analytic framework: (i) since banking is the field, the presumption against preemption is inapplicable; and (ii) a regulator's preemption regulations are just as valid as Congress' preemption statutes, and mandate deference (particularly in the field of banking). The title of the Second Circuit's preemption holding tells all – "Federal Law Preempts the Field of Mortgage Escrow Accounts Held by Federal Savings Associations" (App. A, *infra*, 3a).

To paraphrase then Chief Judge Cardozo in *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 341, 162 N.E. 99 (1928), "Proof of [banking] in the air, so to speak, will not do." As the Supreme Court explained in *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941):

> There is not – and from the very nature of the problem there cannot be – any rigid formula or rule which can be used. . . . Our primary function is to determine whether, *under the circumstances of this particular case*, [the state law] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. (emphasis added)

Accord Rice v. Santa Fe Elevator Corp., 331 U.S. at 230 ("The question in each case is what the purpose of Congress was.").

Notwithstanding the broad language of *de la Cuesta* cited by the Second Circuit, this Court has never held that federal preemption regulations can *trump* the intent and purpose of Congress, or that Congress' purpose in any specific instance

can be arrived at based generally on the nature of the regulated field. To the contrary, although the Court's preemption decisions have evolved over the years, the unifying thread is Congress' intent and purpose, as gleaned from all of the appropriate sources enumerated, *inter alia*, in *Medtronic, supra*. The Second Circuit's preemption holding directly conflicts with Congress' intent, expressed in 12 U.S.C. § 2616, and the Secretary's interpretation in the Federal Register confirming the applicability of § 2616 to state escrow interest laws. *See* Statement of the Case II(B), *supra*.[3]

The Second Circuit also rejected Petitioners' challenge as to whether the OTS Director or the Secretary should be considered the proper federal administrator to issue preemption regulations regarding state escrow interest laws. Rather than address any potential conflict between these officials in this regard, the Second Circuit instead reconciled the ability of both administrators to make preemption determinations by the following analysis (App. A, *infra*, 10a-11a):

> First, RESPA and HOLA are not coextensive. RESPA applies to all mortgage loans that are "federally related." 12 U.S.C. § 2602. HOLA applies to federal

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[3] The Second Circuit's sweeping generalization about the reach of federal preemption in all issues banking also rejected *sub silencio* another of Petitioners' arguments – that this case involves the traditional state police powers regarding consumer protection, thus triggering, or at least implicating, the presumption against preemption. State consumer protection has been held to be such a "historic police power." *See Cliff v. Payco Gen. Am. Credits, Inc.*, 363 F.3d 1113, 1125 (11th Cir. 2004); *Blue Cross & Blue Shield of New Jersey, Inc. v. Phillip Morris, Inc.*, 178 F. Supp. 2d 198, 262 (E.D.N.Y. 2001), *aff'd in relevant part*, 344 F.3d 211 (2d Cir. 2003). *Cf. Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 541-42 (2001) (consumer advertising protection is historic state power entitled to presumption against preemption unless contrary intent of Congressional purpose). The Supreme Court, however, need not solely rely on presumptions here, in light of Congress' express statement in 12 U.S.C. § 2616 that state escrow laws providing "greater consumer protection" are not subject to preemption.

savings associations.12 U.S.C. § 1463. By design, then, RESPA regulates a narrow field of financial transactions engaged in by a broad group of financial institutions, *cf.* 12 U.S.C. § 2606 (describing exempted transactions), while HOLA regulates a specific breed of financial institutions in respect of all of their transactions and activities, *see, e.g., Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta,* 458 U.S. 141, 102 S. Ct. 3014, 73 L. Ed.2d 664 (1982) (due-on-sale clauses); *Bank of Am. v. City and County of San Francisco,* 309 F.3d 551 (9th Cir. 2002) (ATM charges).

Given that HOLA deals with institutions and RESPA deals with transactions, it simply does not make sense to read RESPA as superceding HOLA and preventing the OTS from asserting regulatory authority over the policies and practices of federal savings associations with respect to escrow accounts. The more sensible reading of these statutes is that federal savings associations, like all grantors of mortgage loans, must abide by RESPA as interpreted by the Secretary of Housing and Urban Development. The OTS cannot, therefore, promulgate rules and regulations that are contrary to RESPA. That this is so does not, however, exclude the OTS from preempting the field of rules governing federal savings associations and establishing nationwide regulations governing these institutions that are consistent with federal law, including RESPA.

Similarly, the Second Circuit's entire consideration of the import of 12 U.S.C. § 2616 was relegated to a single footnote (App. A, *infra*, 11a at n.2), stating:

> We have considered the Flaggs' argument that 12 U.S.C. § 2616 bars preemption. For those reasons stated that deal with the general relationship between RESPA and HOLA, we find this argument to be without merit.[4]

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[4] Though more detailed, the Second Circuit's analysis is analogous (Cont'd)

In so holding, the Second Circuit completely ignored the Secretary's published conclusions that a state "law[] regarding escrow accounts . . . is not to be preempted if it gives greater protection to the consumer"; "[w]here interest is required, it is a matter of State law, with fourteen States requiring that some amount of interest be paid on escrow account funds." 59 Fed. Reg. at 53891, 53900. Simply stated, the OTS here has done precisely what the Secretary has claimed it cannot do under RESPA – preempt state consumer escrow interest laws.

The Second Circuit's resort to logic and tautology is inconsistent with Congress' intent. Although it is true that FS&L's are "institutions" and mortgage loans are "transactions," the fact is that both HOLA and RESPA deal with the *"operations"* of banking institutions, with RESPA most specifically dealing with the narrow sliver of banking operations

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(Cont'd)

to the preemption analysis of the First Circuit in *First Fed. S&L Ass'n of Boston v. Greenwald*, 591 F.2d 417, 420 n.3 (1st Cir. 1979), the only other decision to specifically address the relationship of the RESPA saving clause to the authority of the FHLBB/OTS regarding escrow interest. The sum total of the *Greenwald* preemption analysis is as follows:

> The Commissioner reads s 2616 far too broadly. On its face s 2616 only states that "This chapter does not annul, alter, or affect, or exempt any person (from) the laws of any State with respect to settlement practices. . . ." (Emphasis added). Thus, s 2616 relates solely to the preemptive effect of 12 U.S.C. ch. 27, which consists only of RESPA. Section 2616's scope does not extend to 12 C.F.R. § 545.6-11(c), as it was promulgated by the Bank Board pursuant to the Home Owners' Loan Act, 12 U.S.C. § 1464(a), and not pursuant to RESPA.

The *Greenwald* preemption analysis is without citation to any Supreme Court decisions or any consideration of: (i) whether RESPA applies to FS&L's; and (ii) Congress' specific delegation to the Secretary of the authority to regulate escrow accounts and make preemption determinations. *Greenwald* is no more consistent with the preemption decisions of the Supreme Court than is the Second Circuit's Opinion in this case.

concerning the mortgage escrow account operations of all lenders and servicers of "federally related mortgage loans" throughout the life of the loan. With respect to this narrow, specific sliver, the Secretary is the federal official delegated by Congress to administer these operations, as supplemented by the Congressionally preserved power of the States to provide additional consumer protections.

The Supreme Court's decisions applying the rules of recency and specificity in connection with potential statutory conflicts were also brought to the Second Circuit's attention by Petitioners, but were ignored in light of the circuit court's reconciliation of HOLA and RESPA. As this Court stated in *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000): "[T]he meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand." *See also United States v. Estate of Romani*, 523 U.S. 517, 530-531 (1998); *United States v. Fausto*, 484 U.S. 439, 453 (1988). In this case, there is no reference anywhere in HOLA to "escrow accounts," whereas escrow accounts are the *raison d'etre* for RESPA. Thus, Congress' earlier broad delegation to the OTS under HOLA should not be interpreted as overriding Congress' specific, subsequent intent regarding escrow accounts in RESPA.

Decisions of this Court dealing with potentially conflicting administrative delegations also confirm that the Second Circuit was required to defer here to the Secretary and the State's consumer protection powers preserved under RESPA. Judicial deference to an agency's regulatory interpretation under *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984), is appropriate *only* if that agency is the one to which Congress has delegated principal responsibility for the area regulated, with the greatest "expertise." *See, e.g., Martin v. Occupational Review Comm'n*, 499 U.S. 144, 152-53 (1991) (deference given only to agency in best position to interpret statute). *Cf. In re New Times Sec. Servs., Inc.*, 371 F.3d 68, 77-

80 (2d Cir. 2004) (declining *Chevron* deference to SIPC over SEC).[5]

Finally, although the Second Circuit was unable to "discern a critical difference between [*Bank of Am. v. City & County of San Francisco*, 309 F.3d 551 (9th Cir. 2002), and *de la Cuesta*] and the one at bar," (App. A, *infra*, 7a-8a), a close reading of those two opinions in light of this Court's other preemption decisions establishes that they do not support the Second Circuit's preemption holding.

In *Bank of Am.*, the Ninth Circuit considered both HOLA and the language and legislative history of the Electronic Funds Transfer Act ("EFTA") to hold that HOLA trumped the saving clause of the EFTA, and that the states were not allowed to regulate the ATM fees charged by FS&L's. First, 12 U.S.C. § 1464(b)(1)(F) of HOLA specifically addresses the right of FS&L's to "establish remote service units for the purpose of crediting [and debiting] savings or demand accounts." 309 F.3d at 559-60. Additionally, the EFTA language generally indicated that ATM fee limits were not intended within its ambit. *Id.* at 564. But most important, Congress' 1999 amendment to EFTA *specifically* allowed the charging of ATM fees – so long as notice and an opportunity to cancel the transaction were provided. *Id.* at 564-65. Thus, although ruling against applicability of the saving clause, the inconsistency between state laws and the most recent and specific expressions of Congressional intent was determinative.

de la Cuesta, 458 U.S. 141, deals with the broad powers that the FHLBB/OTS can properly exercise preemptively in the

[5] One of the two principal bases stated by the FHLBB/OTS for the preemption of state escrow interest laws – that the preemption regulations are promulgated "pursuant to the plenary and *exclusive authority* of the Office to regulate all aspects of the operations of Federal savings associations," *see* 12 C.F.R. § 545.2 (App. D, *infra*, 63a-64a) (emphasis added) – is legally erroneous. The OTS Director not only lacks "exclusive authority," but even "primary authority," to regulate the escrow accounts required to be maintained by FS&L's and all other "federally related mortgage" lenders.

face of state law generally. It does not address either RESPA or any conflict between HOLA and any other federal statute. Furthermore, in *de la Cuesta*, the FHLBB had determined that elimination of the due on sale clause "will have an adverse [e]ffect on the earning power and financial stability of Federal associations, will impair the ability of Federal associations to sell their loans in the secondary markets, will reduce the amount of home-financing funds available to potential home buyers, and generally will cause a rise in home loan interest rates." 458 U.S. at 168. In this case, in contrast, no adverse effect on the lending operations of FS&L's has ever been articulated, either by Respondent or the OTS.

The principal justification asserted by the OTS Director for its regulation preempting all state escrow account laws was "to give federal savings associations maximum flexibility to exercise their lending powers *in accordance with a uniform federal scheme of regulation.*" *See* 12 C.F.R. § 560.2(a) (App. D, *infra*, 64a) (emphasis added). That justification, however appropriate in connection with all of the other operations of FS&L's, cannot trump the interests of the various states, including New York, in implementing additional consumer protections in connection with escrow accounts that are greater than those prescribed under RESPA and the regulations promulgated thereunder. Here, 12 U.S.C. § 2616 establishes Congress' intent with respect to "federally related mortgage" escrow accounts – that the states' interest in consumer protection regarding mortgage escrow accounts *overrides* the federal interest in "maximum flexibility" or "uniformity pursuant to a federal scheme." *See Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 871 (2000) ("[T]he savings clause reflects a congressional determination that occasional nonuniformity is a small price to pay for a system in which juries not only create, but also enforce, safety standards, while simultaneously

providing necessary compensation to the victims. That policy by itself disfavors pre-emption[.]").[6]

In *de la Cuesta*, the Supreme Court observed, 458 U.S. at 167: "Although the Board's power to promulgate regulations exempting federal savings and loans from the requirements of state law may not be boundless, in this case we need not explore the outer limits of the Board's discretion." This is the case that resides at "the outer limits of the Board's discretion." But the location of its residence does not diminish its importance in the federal/state scheme.

II. Review Is Warranted Because The Second Circuit Opinion Ignores And Misapplies This Court's Taking Decisions

As this Court observed in *Phillips v. Washington Legal Found.*, 524 U.S. at 165:

> The rule that "interest follows principal" has been established under English common law since at least the mid-1700's. *Beckford v. Tobin*, 1 Ves. Sen. 308, 310, 27 Eng. Rep. 1049, 1051 (Ch. 1749) ("[I]nterest shall follow the principal, as the shadow the body"). Not surprisingly, this rule has become firmly embedded in the common law of the various States.

Other cases in addition to *Phillips* further confirm that the owner of funds held in escrow has a property right in the interest which is subject to the protections of the Takings Clause of the Fifth Amendment. *See Webb's Fabulous Pharmacies, Inc. v. Beckwith*, 449 U.S. 155 (1980); *McIntyre v. Bayer*, 339 F.3d 1097, 1099-1100 (9th Cir. 2003) (prison inmates have cognizable Takings Clause property interest in interest on funds in inmate trust accounts); *Cmty. Bank & Trust v. United States*, 54 Fed. Cl. 352, 359 (Ct. Cl. 2002) (bank has cognizable Takings Clause

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[6] *Cf. Atherton v. FDIC*, 519 U.S. 213, 219-20 (1997) ("To invoke the concept of 'uniformity' . . . is not to prove its need."); *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 730 (1979) (rejecting "generalized pleas for uniformity as substitutes for concrete evidence that adopting state law would adversely affect administration of the federal programs").

property interest in income earned by Federal Reserve on funds held in reserve accounts).

Concomitantly, federal preemption of property rights without just compensation violates the Takings Clause. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1012 (1984); *Spinelli v. Gaughan*, 12 F.3d 853, 858 n.5 (9th Cir. 1993); *Swisher v. United States*, 176 F. Supp. 2d 1100, 1102 (D. Kan. 2001); *Glosemeyer v. United States*, 45 Fed. Cl. 771, 776 (Ct. Cl. 2000).

Petitioners' federal taking claim was asserted on the basis of Respondent's affirmative representation that it was relying on OTS preemption and a federal preemption defense to avoid paying escrow interest, and that fact was affirmatively alleged in Petitioners' complaint and is uncontroverted. Respondent also sent a letter dated July 3, 2003 to the OTS requesting that the OTS issue an opinion letter *in this case* that the OTS regulations eliminate Respondent's obligation under New York law to pay escrow interest. The OTS obliged, by letter dated October 6, 2003, stating that defendant did not have to pay interest because the OTS said so under the OTS preemption regulations. The Second Circuit simply failed to address these facts in its Opinion.

To avoid the clear implication of these facts and the above-cited decisions, the Second Circuit substantially adopted the rationale of the district court (App. B, *infra*, 53a-57a) that the facts here do not implicate the Fifth Amendment because of a lack of "state action." According to the Second Circuit (App. A, *infra*, 14a-15a):

> *Though Yonkers is a "federal savings association," it is a private corporation*, not a state agency. "For the conduct of a private entity to be fairly attributable to the state, there must be such a close nexus between the State and the challenged action that seemingly private behavior may be fairly treated as that of the State itself." *Cranley v. Nat'l Life Ins. Co.*, 318 F.3d 105, 111 (2d Cir. 2003) (internal quotations omitted). A nexus of "state action" exists between a private entity and

> the state when "the state exercises coercive power, is entwined in the management or control of the private actor, or provides the private actor with significant encouragement, either overt or covert, or when the private actor operates as a willful participant in joint activity with the State or its agents, is controlled by an agency of the State, has been delegated a public function by the state, or is entwined with governmental policies." *Id.* at 112 (internal quotations and alterations omitted). By these well-established standards, no nexus existed between the OTS and Yonkers's decision not to pay interest on the Flaggs' escrow account.
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> *While federal law freed Yonkers, as a federal savings association, from any legal duty to pay interest on mortgage escrow accounts, there was no federal mandate prohibiting Yonkers from paying interest to the Flaggs or any other mortgagee-client. Neither did any state agent advise or command that Yonkers not pay interest on mortgage escrow accounts.* In fact, the OTS was neutral on the subject, leaving negotiation of interest payments on escrow accounts to the contracting parties. Neither the OTS nor any other state agency was party to the Flaggs' contract with Yonkers. There was no OTS-Yonkers joint enterprise; and no state function was delegated to Yonkers as a mortgagor. In short, Yonkers was a private entity participating in a regulated field of activity. Yonkers's actions were consistent with the law, to be sure, but obedience to the law alone does not create a sufficient nexus with the state to sustain a finding of "state action." (emphasis added)

The Second Circuit Opinion errs, first, because Respondent was not *merely* a "private corporation" for Fifth Amendment purposes. Rather, Respondent and all other FS&L's are federal instrumentalities. *See First Fed. Sav. & Loan Ass'n of Jackson County v. First Fed. Sav. & Loan Ass'n of Huntsville*, 446

F. Supp. 210, 212 (E.D. Ala. 1978) ("Federal associations are agencies and instrumentalities of the United States[.]"). *Cf. Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*, 439 U.S. 299, 308 (1978) ("Omaha Bank is a national bank; it is an 'instrumentalit[y] of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.'") (citation omitted). As the OTS itself has recognized, "federal savings associations are *uniquely federalized financial institutions – even more so than national banks*." *See* OTS Opinion Letter dated December 24, 1996 regarding Preemption of State Laws Applicable to Credit Card Transactions (submitted by Respondent in support of motion to dismiss) (emphasis added). Federal instrumentalities are subject to constitutional limitations. *San Francisco Arts & Athletics, Inc. v. United States Olympic Comm.*, 483 U.S. 522, 549 (1987) (Brennan, J., dissenting).

Although recognizing it was the OTS regulations that "freed [Respondent] from any legal duty to pay interest on mortgage escrow accounts," the Second Circuit nevertheless held such circumstance insufficient for "state action," essentially because the OTS did not affirmatively prevent Respondent from paying escrow interest (App. A, *infra*, 15a). The Second Circuit's holding misconstrues or overlooks the decisions by this Court that substantial "encouragement" or "involvement" satisfies the "state action" nexus requirement. *See San Francisco Arts & Athletics, Inc.*, 483 U.S. at 546 (state action where government "has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the" government); *Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 927 (1982) (state action where "there was overt, official involvement in the property deprivation"); *Blum v. Yaretsky*, 457 U.S. 991, 1003 (1982) (state action where defendant "sufficiently received the imprimatur of the State" or state is directly or indirectly "responsible for the specific conduct" of defendant). *Cf. Am. Mfrs. Mut. Ins. Co. v. Sullivan*, 526 U.S. 40, 52 (1999) (no state action when decision involves purely "private parties, and 'turns

on . . . judgments made by private parties' without 'standards . . . established by the State") (quoting *Blum*, 457 U.S. at 1008).

As this Court observed in *de la Cuesta*, 458 U.S. at 155:

> [Preemptive force] does not evaporate because the Board's regulation simply permits, but does not compel, federal savings and loans to include due-on-sale clauses in their contracts and to enforce those provisions when the security property is transferred.

The Court's observation is particularly apt here. It is Respondent's willful assertion of preemption under the OTS regulation that constitutes state action, regardless of whether that assertion is an "option" provided to it by the OTS, or a requirement. Either way, the state action nexus is satisfied. And the fact that the taken interest can be readily calculated from the same escrow account information already required to be provided to all borrowers annually under 12 U.S.C. §§ 2609(b) and 2609(c)(2) eliminates any uncertainty as to the taking's existence.

Petitioners finally observe that they encouraged the Second Circuit to obviate the need to consider the taking claim by following the well-established rule that "a regulation should be construed, whenever possible, so as to avoid constitutional issues." *Ames v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 567 F.2d 1174, 1181, n.7, 1182 (2d Cir. 1977). *See also, e.g., Ashwander v. Tenn. Valley Auth.*, 297 U.S. 288, 348 (1936); *Ma v. Ashcroft*, 257 F.3d 1095, 1106 (9th Cir. 2001); *Adams v. City of Battle Creek,* 250 F.3d 980, 986 (6th Cir. 2001). Petitioners' pleas fell on unreceptive ears. Petitioners hope their entreaty will prove more persuasive with this Court.

III. Review Is Warranted Because The Important Federal And Constitutional Issues In This Case Have A Direct Effect On A Substantial Segment Of The U.S. Populace Who Have Been, And Will Be, Injured By The Challenged Escrow Interest Preemption

As Rep. Leonor K. Sullivan stated in 1975, H.R. Rep. No. 94-667 (1975), *reprinted in* 1975 U.S.C.C.A.N. 2448, 2461: "The GAO reported that about $9 ½ billion was being placed over a year's time in such accounts on one to four family dwelling units[.]" Petitioners have no hard figures concerning the present amount, but with the geometric increase in housing prices and the costs of taxes and insurance since 1974, an estimate 10 times that amount, equaling $90.5 billion dollars annually, would not seem unreasonable. At a modest 2% per year, the interest on that principal could total almost $2 billion or more. And as Petitioners observed, *supra*, it is reasonable to estimate that the amount attributable solely to FS&L's in the states requiring the payment of interest could involve hundreds of thousands or more borrowers and hundreds of millions or more dollars of escrow interest – every year.

There is more. At the time this action first was commenced, to the best of Petitioners' knowledge, FS&L's were the only banking institutions who were not required to pay the interest on escrow balances prescribed under state law. National banks and national associations, by comparison, did pay escrow interest required by state law, the same as all other state banking institutions. But the uniqueness of the FS&L preemption exemption has now changed.

In August, 2003, the Office of the Comptroller of the Currency ("OCC") published substantial proposed revisions to its prior regulations in the Federal Register, 68 Fed. Reg. 46119 (Aug. 5, 2003). The proposed revisions, involving 12 C.F.R. Parts 7 and 34, included "provisions clarifying the applicability of state law to national banks."

In January, 2004, the OCC published the final regulations, which became effective on February 12, 2004. *See* 69 Fed. Reg. 1904 (Jan. 13, 2004). The new and revised regulations included revised 12 C.F.R. § 34.4(a)(6) – which now specifically provides that "[a] national bank may make real estate loans under 12 U.S.C. 371 and § 34.3, without regard to state law limitations concerning. . . . (6) Escrow accounts, impound accounts and similar accounts." 69 Fed. Reg. at 1917.

Thus, wholly aside from the legal importance of this case, which Petitioners believe is great, the economic importance of the case has been ratcheted up substantially since it was commenced, as a result of the new OCC preemption regulations mirroring those by the OTS. Regulator conduct this far-reaching is something, Petitioners respectfully contend, that this Court should address, particularly in light of the substantial federalism and Constitutional implications engendered.

CONCLUSION

For all of the foregoing reasons, Petitioners respectfully request that the Supreme Court grant review of this matter.

Respectfully submitted,

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